Select Super, Pension & Investments

ANNUAL UPDATE 2015/16

July 2016

This annual update provides an overview of financial markets, how we invest your money and summarises key legislative developments that may affect you. Your enclosed annual statement for 2015/16 provides details of your account and transactions.

WELCOME TO YOUR ANNUAL UPDATE

These are challenging times for investors, with record low interest rates, mixed signals on economic growth and a constant stream of global risks, such as questions over the future shape of Europe reverberating around financial markets.

In this environment, our job is to maintain perspective and a clear focus on what we are trying to achieve for our investors. A key focus is being cognisant of the risk members are exposed to. In this environment the temptation to increase risk in order to maintain income levels, or 'reach for yield', needs to be tempered with the need to preserve investors' capital.

The Select investment team manages members' funds under a proven investment philosophy, based on prudent investment principles and active oversight of each portfolio.

Our Select multi-manager portfolios are constructed to provide the benefits of diversification at every level. The team allocates each portfolio's exposure across a broad asset range, as well as selecting the best specialist managers for each asset class. The aim is to increase the sources of return while mitigating the overall risks. Allocations to alternative assets such as infrastructure and specialist credit, provide additional diversification benefits for investors.

In the most recent Federal Budget the Government proposed a number of changes to superannuation, including restricting the amounts that can be contributed over a lifetime.

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A summary of these proposed changes is provided on page 4 of this update.

Whatever changes eventuate, they will not diminish people's motivation to provide for their financial future, which is what we are here to help you do.

The Select investment menu has been designed to enable you to choose an option that suits your particular goals and stage in life.

If you believe you might benefit from personal financial advice, Perpetual's highly qualified financial advisers can advise on investments, superannuation and retirement planning, as well as providing specialised services such as tax and estate planning.

If you have any questions about your investments, or would like to speak to one of our advisers please contact us on 1800 003 001.

Thank you for entrusting us with your investments.

MARK SMITH
Group Executive,
Perpetual Private

WHAT HAPPENED IN FINANCIAL MARKETS?

AUSTRALIAN SHAREMARKET

The Australian sharemarket rose +0.6% in FY16 with a price decline of -4.1%, mostly offset by our high dividend income. Although lower, Australian shares outperformed most of our international peers in both price return (an average of -8.5%) and dividend (2.5%), even though our two major sectors, banks and resources, faced a more difficult trading environment. The two headwinds that have restrained returns over the year are elevated valuations and a more difficult earnings environment, which capped gains despite increased policy support from the Federal government and the Reserve Bank of Australia (RBA).

During the financial year, there were two distinct periods of volatility in August/September 2015 and January/February 2016, which sparked larger-than-normal losses. However, central bank intervention stabilised the global backdrop and enabled markets to recover. On the macro front, Australian economic growth accelerated as the country continued to transition from the mining investment boom, with unemployment declining to a 3-year low of 5.7% and housing construction remaining upbeat given favourable interest rate settings.

INTEREST RATES

Despite numerous international headwinds the Australian economy has performed strongly over the past year, with growth of 3.1%, which is around double most of our G20 (Group of Twenty) advanced economy peers. Despite this, the Reserve Bank of Australia cut the target cash rate to a fresh record low of 1.75% given concerns that both headline and core inflation is too far below their 2–3% target band, which is something that has been evident in international economies over the past five years. More importantly, the Bank seemingly believes that inflation is likely to remain at historically low levels for an extended period, which is good news for household budgets, but not for nominal earnings growth or the Federal Budget. Lower inflation also culminated in our 10-year bond yield trading below 2.0% for the first time ever, with the downward pressure amplified by falling global yields in response to a weaker international climate, central banks' asset purchase programs in Europe and Japan, and specific risk events, including Britain's referendum on EU membership.

THE AUSTRALIAN DOLLAR

The Australian dollar declined for a second consecutive year. Despite several key headwinds the currency proved quite resilient as investors remained attracted to our relatively high yields, which helped offset the impact of a sustained reduction in commodity prices. Elsewhere, there appears to be more pressure on Australia's AAA credit rating (which has been a keystone to the currency's strength over the past six years), given Australia's growing debt burden, even though this stock of government debt remains modest relative to other major global economies. The positive and negative factors impacting the currency culminated in the Australian dollar depreciating modestly against most major international currencies, including the Yen, Euro and US dollar and appreciating slightly against the major Asian currencies, as a moderation in China's growth profile weighed heavily on commodity exposures.

ALTERNATIVE ASSETS

Alternative assets, while not meeting their 'cash-plus' benchmarks, have managed to deliver positive absolute returns in an environment of flat and highly volatile equity markets. This has served to boost overall portfolio returns, delivered better downside protection and reduced overall portfolio risk.

Interest rates have continued to be held at historic lows, despite efforts and commentary from the Fed (the central banking system of the United States) to the contrary. Our defensive alternative exposures are generally in floating-rate securities, ensuring that the impact from any surprise rate moves by central banks will be relatively muted compared to traditional bond benchmarks. Even though this position has detracted from relative returns over the year, we believe that taking less duration relative to benchmark is prudent given the possibility of a surprise to the upside on rates.

We continue to make investments opportunistically in the alternatives sector, taking advantage of dislocation in the European banking sector and investing in less efficient markets, such as private equity, private lending and unlisted property and infrastructure. Given the uncertain outlook for the global economy, increasing portfolio diversification and seeking alternative sources of return has become more important than ever for investors.

PROPERTY

Real Estate Investment Trusts (REITs) have continued to rally in the face of low interest rates and investors seeking yield. Both domestic and global exposures (which we hedge back to Australian dollars) have contributed strong positive double digit returns for portfolios over the last twelve months, well in excess of our long-term return expectations for this asset class.

We expect valuations to remain elevated in the short-term, however it also makes us increasingly nervous about incredibly challenging prices for real estate, despite gearing remaining relatively conservative across the board. In line with our investment philosophy, the managers we employ in this asset class display strong downside risk attributes, focusing on quality assets, a strong record of governance and alignment to investors when selecting REITs for investment. This will hold Select investors in good stead should REIT markets correct in response to a change in rate expectations by the market.

0.56%

Return from the Australian sharemarket over the financial year

S&P/ASX 200 returned +0.56%.

Broken down to a -4.13% price decline offset by +4.69% dividend income

1.75%

The Reserve Bank of Australia cash rate (as at 30 June 2016)

AUD $

High

78.12c

Low

68.67c

Australian Dollar from 1 July 2015 to 30 June 2016

FROM THE SELECT MANAGER

The 2016 financial year was a challenging one for markets. Equity markets globally delivered negative returns and bonds, already expensive, continued to rally in a world where uncertainty rules. The year was bookended by geopolitical events in Europe, with overall concerns around slowing global growth and rising U.S. interest rates the main themes throughout.

The financial year started with significant angst around a Greek debt default, resulting in the September 2015 quarter delivering the worst returns for equity markets since 2011. This was followed by a crash in global oil prices on the back of Chinese growth concerns combined with negative implications of a strengthening U.S. dollar on emerging markets (EM). We saw the effects of this reverberate through global markets, in particular high-yield bonds (dominated by energy companies) and EM equity and debt markets were sold off heavily.

A small rally late in the March 2016 quarter provided some relief for investors, however the final quarter of the year was dominated by the United Kingdom's decision to leave the Eurozone after 43 years. Significant volatility in currency and equity markets was experienced as the market entered a new period of uncertainty, driven by the largely unknown effects that the Brexit may cause on global growth.

When it comes to diversified funds, balanced options in Australia generally have a higher relative exposure to equity markets than global peers, which has resulted in flat to negative returns for investors over the past twelve months.

At Perpetual Private, we position client portfolios in line with our 'Protect and Grow' philosophy. While we may not have been able to achieve returns in line with the long-term objectives of our funds, we are comforted by the fact that relative to peers in the industry, we have held up relatively well in difficult market conditions, delivering flat to modestly positive returns. We can attribute this to a higher level of diversification at an asset class level, as well as the focus of the managers we employ, which tend to display superior downside risk protection in volatile markets.

By protecting first, our clients will have a higher capital base from which to participate when markets start to normalise – this is our proven method to growing our clients' wealth over the long-term.

KYLE LIDBURY
Head of Investment Research

SUPERANNUATION PRODUCT AND LEGISLATIVE CHANGES

PROPOSED CHANGES TO SUPER

In his budget announced on 3 May 2016 Treasurer Morrison announced a number of proposed changes to superannuation, mainly relating to how much can be contributed and the tax concessions available.

Following is a summary of the key proposals. It is important to note that at the time of writing, none of these proposals have been legislated, and as such may not proceed.

To ensure you get the right advice for your situation, please consider speaking to a Perpetual adviser.

ANNUAL CONCESSIONAL CONTRIBUTION CAP REDUCED

From 1 July 2017 the annual concessional (before-tax) contribution cap will reduce to $25,000 per year for all ages, down from the current caps of $30,000 for people under 50 and $35,000 for those 50 and over.

$1.6 MILLION SUPER TRANSFER BALANCE CAP

From 1 July 2017, there will be a $1.6 million cap on the total amount that can be used to commence a superannuation pension. This cap will apply to existing pension balances as of 1 July 2017.

CATCH-UP CONCESSIONAL CONTRIBUTIONS ALLOWED

From 1 July 2017, someone who has not reached their concessional contributions cap in a year will be able to carry forward the unused amount to future years, on a rolling basis for up to five years, provided their super balance is less than $500,000. This enables people who are out of the workforce for extended periods to catch up with increased contributions later on.

LIFETIME NON-CONCESSIONAL SUPER CONTRIBUTIONS CAP

Effective 3 May 2016 when it was announced, the lifetime cap for non-concessional (after-tax) contributions (NCC) is $500,000, replacing the current annual NCC cap of $180,000 per year.

Any NCCs made prior to 3 May 2016 can be retained but after this date any contributions in excess of the cap will need to be removed, or be subject to penalty tax. At the time of writing, no information is currently available on the details of the penalty tax. Anyone will be able to make NCCs up to the lifetime cap until the age of 74, without having to meet a work test.

SUPER WORK TEST ABOLISHED FOR THOSE AGED 65 TO 74

From 1 July 2017, older Australians will be able to contribute to superannuation regardless of their work status. The current work test requirement to contribute to superannuation for those aged between 65 and 74 will be removed – placing them on the same footing as those under age 65. This will allow retirees to continue increasing their retirement savings for a longer period.

INCREASED SUPER CONTRIBUTIONS TAX FOR HIGH INCOME EARNERS

From 1 July 2017, people on an income of $250,000 and above will pay an increased level of contributions tax on concessional contributions – from 15% to 30%.

TRANSITION TO RETIREMENT PENSION TAX EXEMPTION REMOVED

Transition to Retirement (TtR) pensions when coupled with increased salary sacrifice have been a way for those who have reached preservation age but not yet retired, to boost their super while maintaining their income. Currently, assets supporting TtR income streams enjoy tax-free earnings.

From 1 July 2017, the tax exemption on transition to retirement (TtR) pensions will be removed. This means that the capital underpinning the TtR pensions will be taxed in the same way as super funds. Importantly, while the income payments from a TtR pension will still be taxed in the same way (ie. these will remain tax-free for people over age 60), the flexibility to treat pension payments from TtRs as lump sums for tax purposes will also be eliminated.

+% CHANGE TO INCOME TAX THRESHOLD

INCOME TAX

The personal income threshold for the 32.5% tax bracket has increased from $80,000 to $87,000 from 1 July 2016.

MORE INFORMATION

Speak to your Adviser or contact us:
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